

TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING # 18-03

Letter rulings are binding on the Department only with respect to the individual taxpayer being addressed in the ruling. This ruling is based on the particular facts and circumstances presented, and is an interpretation of the law at a specific point in time. The law may have changed since this ruling was issued, possibly rendering it obsolete. The presentation of this ruling in a redacted form is provided solely for informational purposes, and is not intended as a statement of Departmental policy. Taxpayers should consult with a tax professional before relying on any aspect of this ruling.

SUBJECT

The application of the Tennessee excise tax deduction for distributions made by a partnership to a public REIT that include net earnings or losses of the partnership's subsidiaries.

SCOPE

This letter ruling is an interpretation and application of the tax law as it relates to a specific set of existing facts furnished to the Department by the taxpayer. The rulings herein are binding upon the Department, and are applicable only to the individual taxpayer being addressed.

This letter ruling may be revoked or modified by the Commissioner at any time. Such revocation or modification shall be effective retroactively unless the following conditions are met, in which case the revocation shall be prospective only:

- (A) The taxpayer must not have misstated or omitted material facts involved in the transaction;
- (B) Facts that develop later must not be materially different from the facts upon which the ruling was based;
- (C) The applicable law must not have been changed or amended;
- (D) The ruling must have been issued originally with respect to a prospective or proposed transaction; and
- (E) The taxpayer directly involved must have acted in good faith in relying upon the ruling; and a retroactive revocation of the ruling must inure to the taxpayer's detriment.

FACTS

[Public REIT] (the "Public REIT") is a public real estate investment trust, as defined in TENN. CODE ANN. § 67-4-2004(39) (Supp. 2017). The Public REIT owns a controlling interest in [Partnership, L.P.] (the

“Partnership”) and is its sole general partner. The Partnership in turn owns several limited liability companies and limited partnerships (the “Taxpayers”) that operate as lessors of residential property in Tennessee. The Taxpayers own real property in Tennessee, but the Public REIT has no contacts in Tennessee beyond the Taxpayers’ activities. The Partnership makes annual distributions of its net earnings to the Public REIT, which include the Taxpayers’ net earnings.

The Partnership is classified as a partnership for federal tax purposes. Each Taxpayer is treated as having a single owner and is disregarded as a separate entity for federal tax purposes. For Tennessee franchise and excise tax purposes, the Taxpayers are treated as separate entities and each files its own franchise and excise tax return. None of the Taxpayers are owned by captive REITs, as defined in TENN. CODE ANN. § 67-4-2004(7) (Supp. 2017).

RULING

Do the Taxpayers qualify for the excise tax deduction under TENN. CODE ANN. § 67-4-2006(a)(5)(A) (Supp. 2017) for distributions the Partnership makes to the public REIT, which include the Taxpayers’ net earnings?

Ruling: Yes. The Taxpayers qualify for the deduction under TENN. CODE ANN. § 67-4-2006(a)(5)(A) because they are treated as a division of the Partnership for federal income tax purposes.

ANALYSIS

Tennessee imposes an excise tax at the rate of 6.5% on the net earnings of all persons doing business in Tennessee.¹ Tennessee also imposes a franchise tax at the rate of \$0.25 per \$100, or major fraction thereof, on the net worth of a person doing business in Tennessee.² Persons subject to the Tennessee franchise and excise taxes include, but are not limited to, corporations, REITs, limited liability companies, and limited partnerships.³ With certain limited exceptions, each taxpayer is considered a “separate and single business entity” and must file its Tennessee franchise and excise tax return on a separate entity basis.⁴

For Tennessee excise tax purposes, a taxpayer may deduct from net earnings or loss any amount “distributed either directly or indirectly to a public REIT,” provided that the taxpayer is “treated as a partnership for federal tax purposes that is directly or indirectly owned by a public REIT.”⁵ Additionally, a taxpayer that is “treated as a partnership for federal tax purposes” and “directly or indirectly distributes one hundred percent (100%) of its net earnings or net losses to a public REIT” is entirely exempt from the Tennessee excise tax.⁶

¹ TENN. CODE ANN. § 67-4-2007(a) (Supp. 2017).

² TENN. CODE ANN. §§ 67-4-2105(a) and -2106(a) (2013 & Supp. 2017). This ruling does not address the Taxpayers’ liability for franchise tax. As of the date of this letter, however, the Taxpayers are registered for and pay Tennessee franchise tax.

³ TENN. CODE ANN. § 67-4-2004(38) (Supp. 2017).

⁴ TENN. CODE ANN. §§ 67-4-2007(e)(1), -2106(c) (2013 & Supp. 2017).

⁵ TENN. CODE ANN. § 67-4-2006(a)(5)(A) (Supp. 2017).

⁶ TENN. CODE ANN. § 67-4-2019 (2013).

Treas. Reg. § 301.7701-2(a) (2016) clarifies the federal treatment of various business entities, stating that “[a] business entity with two or more members is classified for federal tax purposes as either a corporation or partnership. A business entity with only one owner is classified as a corporation or is disregarded; if the entity is disregarded, its activities are treated in the same manner as a ... division of the owner.”

The Taxpayers are described as limited partnerships and limited liability companies with one owner, the Partnership. Under Treas. Reg. § 301.7701-2(a), the Taxpayers will be classified as either a corporation or will be disregarded for federal income tax purposes.⁷ None of the Taxpayers have elected to be classified as a corporation by filing Form 8832 (Entity Classification Election). Thus, each Taxpayer is disregarded for federal tax purposes. Being an entity that is disregarded as separate from its owner for federal tax purposes is not in and of itself a classification, but instead, a default whereby the entity's federal tax treatment is the same as its owner's classification. As disregarded entities, the Taxpayers are treated as divisions of the Partnership and therefore qualify as partnerships owned by the Public REIT.

Accordingly, the Taxpayers qualify for the deduction under TENN. CODE ANN. § 67-4-2006(a)(5)(A) and may reduce their net earnings by any amount distributed directly or indirectly to the Public REIT. If a Taxpayer distributes 100% of its net earnings or losses to the Public REIT, it qualifies for the excise tax exemption under TENN. CODE ANN. § 67-4-2019.

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APPROVED: David Gerregano
Commissioner of Revenue

DATE: 8/13/18

⁷ 26 C.F.R. § 301.7701-2.